

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

IN RE LAKE TAHOE PARTNERS, LLC.

Case No. 16-10150

Debtor.

MEMORANDUM DECISION RE MOTION TO DISMISS
AND MOTION FOR RELIEF FROM STAY

The court held a hearing on April 19, 2016 regarding the motion by secured creditor Sorm Investments, LLC (Sorm) to have this court dismiss this Chapter 11 case or grant Sorm relief from the automatic stay. Gary M. Kaplan appeared for Sorm. Michael J.M. Brook appeared for Debtor. Lynette Kelly appeared for the United States Trustee.

Upon due consideration, and for the reasons set forth below, the court determines that the case should not be dismissed and that the motion for relief from stay should be denied at this time, but that a Chapter 11 trustee should be appointed immediately.

FACTS

This is a single-asset real estate case. Debtor's principal asset is undeveloped land on the shores of Lake Tahoe (the Property), which Debtor is attempting to develop. Debtor obtained a \$7.5 million bridge loan from Sorm in August 2012. Debtor defaulted

1 on that loan by failing to make payments due Sorm and by failing to pay real property
2 taxes.¹

3 When Sorm initiated non-judicial foreclosure, Debtor twice sought injunctive
4 relief from the California Superior Court. On each instance, Debtor represented that it
5 soon would obtain new financing sufficient to repay Sorm but thereafter failed to secure
6 that financing. The Superior Court granted a temporary restraining order, but vacated the
7 TRO and denied injunctive relief when Debtor failed to obtain the promised new
8 financing. Facing an imminent foreclosure sale, Debtor filed a Chapter 11 petition in this
9 court on March 1, 2016.

10 Debtor's schedules represent that the value of the Property is \$26 million. Sorm
11 holds a first deed of trust and claims it is owed \$11 million. There are two junior deeds
12 of trust securing debts totaling \$3.5 million. Debtor lists unsecured claims totaling \$1
13 million, \$120,000 of that amount owed to non-insiders.

14 Sorm filed the present motion three weeks after the petition was filed. Sorm
15 contends that the petition should be dismissed because it was not filed in good faith,
16 arguing that this is essentially a two-party dispute, that Debtor has no reasonable
17 prospects for a successful reorganization, and that the petition was filed solely to stop a
18 foreclosure sale after the state court declined to block the foreclosure. Sorm also
19 contends that Debtor's failure to pay real estate taxes constitutes gross mismanagement.²
20 Sorm seeks relief from stay on the basis that Debtor's failure to pay real property taxes,
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23 ¹ Debtor contends that all payments due Sorm were deferred to 2017 under a
24 Modification Agreement signed in June 2013. The Superior Court found that this
25 Modification Agreement did not go into effect, because it was contingent upon a partial
26 payment of principal that Debtor failed to make. This court has no basis to find that the
27 Modification Agreement excused Debtor's failure to pay Sorm, because Debtor failed to
28 provide this court a copy of the Modification Agreement that Debtor contends is so
crucial.

² Sorm's counsel also contends that the case should be dismissed because Debtor has not
submitted evidence that it obtained all the consents required under its own operating
agreement for filing a bankruptcy petition. I decline to reach this issue, because it was
not raised in the memorandum supporting Sorm's motion to dismiss (docket #38).

1 which constitute a lien senior to Sorm's lien, is eating away the value of Sorm's
2 collateral.

3 In response to the motion to dismiss, Debtor first submitted a draft Chapter 11
4 plan, which promised to pay all creditors in full from a new loan to be obtained (docket #
5 55-1), then later submitted a term sheet regarding a sale of the Property to a newly
6 formed entity in which the CEO of Debtor's managing member would be part owner
7 (docket #83). That term sheet provided for the immediate payment of all liens against the
8 Property, but did not explicitly provide for any payment to unsecured creditors, even
9 though Debtor contends the estate is fully solvent.

10 In response to the motion for relief from stay, Debtor contends that Sorm's lien is
11 adequately protected by the value of the Property. Debtor submitted declarations from
12 the CEO and CFO of Debtor's managing member, stating that the value of the Property is
13 \$26 million (docket #56, 62). The unpaid taxes and debt to Sorm total less than \$12
14 million.

15 DISCUSSION

16 A. Motion to Dismiss

17 I decline to dismiss this case. I do not find that Debtor filed its Chapter 11
18 petition in bad faith. This case is not purely a two-party dispute: there are significant
19 non-insider secured and unsecured creditors that would be harmed by the foreclosure sale
20 that would have occurred had Debtor not filed the petition; and Debtor had a good faith
21 basis to believe that all creditors would be paid in full in a bankruptcy. Equally
22 important, Debtor has proposed to sell the Property immediately. In the more typical bad
23 faith petition, the debtor seeks to hold onto over-encumbered property through a
24 visionary scheme of reorganization. Even if Debtor is guilty of pre-petition
25 mismanagement, that mismanagement does not justify dismissal where creditors will
26 likely be paid only if Debtor remains in bankruptcy and deficiencies in management can
27 be remedied by appointment of a trustee.

1 I do find cause to order the appointment of a Chapter 11 trustee immediately.
2 Debtor proposes to sell its only significant asset to an entity related to Debtor and its
3 principals. Although Debtor represents that the value of the Property exceeds all secured
4 and unsecured debts by about \$14 million, the term sheet for the proposed sale contains
5 no provision for the payment of unsecured creditors. Furthermore, given the Debtor's
6 past failures to obtain new financing when promised, it is appropriate to be skeptical as to
7 whether the proposed sale will actually close. In this setting, it is appropriate to enlist the
8 offices of a Chapter 11 trustee to further a prompt sale of the Property on terms fair to the
9 estate. It is only a minor intrusion on the prerogatives of a Chapter 11 debtor to appoint a
10 trustee where the debtor itself proposes an immediate sale of the property. In this case,
11 that limited intrusion is justified by Debtor's past inability to obtain refinancing and by
12 the need for scrutiny of the insider sale the Debtor has proposed. The proposed sale can
13 be offered to the trustee, and if the proposed purchaser is ready and able to close and the
14 sale terms are fair to creditors, there is no reason to believe that the trustee would decline
15 it. But given the duration of the default and the failure of Debtor's past rescue efforts, it
16 is appropriate to enlist a trustee to seek other offers for the Property.

17 B. Motion for Relief from the Automatic Stay

18 Sorm seeks relief from stay on the basis that its collateral is not adequately
19 protected. 11 U.S.C. §362(d)(1). Specifically, Sorm contends that Debtor's failure to
20 pay real property taxes, which by law constitute a lien senior to Sorm's lien, is reducing
21 the value of the collateral available to secure repayment of the debt owed Sorm. This is a
22 well-recognized basis for relief from stay if the value of the Property is not sufficient to
23 pay both the taxes and the debt to Sorm.

24 Debtor contends that Sorm is adequately protected because the Property has a
25 value of \$26 million and the unpaid taxes and the debt to Sorm total less than \$12
26 million.

27 Debtor bears the burden of proving that Sorm is adequately protected. 11 U.S.C.
28 §362(g)(2). Debtor submitted declarations from the CEO and CFO of its managing

1 member stating that the value of the Property is \$26 million. Sorm submitted no
2 evidence of value, but objects to the admissibility of the evidence submitted by Debtor.

3 It is well established that the owner of real property is competent to render lay
4 opinion regarding the value of that property. In re Biddiscombe, Intern., LLC, 392 B.R.
5 909, 918-19 (Bankr. M.D.Fla. 2008). Where the landowner is a corporation or other
6 entity, an appropriate officer of that entity may offer admissible lay opinion regarding
7 value. *Id.* In this case, I determine that Mr. Wilkins, the CEO of Debtor's managing
8 member, is an officer qualified to render lay opinion regarding the value of Debtor's
9 principal asset. While his declaration refers to prior appraisals, which he has not been
10 shown qualified to evaluate, it is clear that he is also relying on his personal knowledge
11 of the Property (docket # 62, ¶5). Such lay opinion is not as persuasive as a qualified
12 appraisal, but as of the moment it is the only evidence of value before the court, and is
13 therefore sufficient to carry the Debtor's burden of proof regarding adequate protection.

14 The record does not support a grant of relief from stay at this time. This
15 determination does not bar Sorm from renewing its motion, but any renewed motion
16 should be filed only after the Chapter 11 trustee has been appointed and has had a
17 reasonable opportunity to evaluate the Property. It is, of course, possible that the trustee
18 will determine that there is no equity in the Property and will consent to relief from stay.
19 If, however, the trustee determines that there is equity in the Property and that it should
20 be offered for sale, the most appropriate course of action may be to monitor the sale
21 process closely to ensure that the Property is marketed expeditiously.

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23 Date: April 21, 2016

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27 Thomas E. Carlson
U. S. Bankruptcy Judge
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